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C O N F I D E N T I A L SECTION 01 OF 02 SANAA 001877

SIPDIS

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E.O. 12958: DECL: 07/11/2015
TAGS: ECON EFIN EINV EPET KMPI KMCA YM ECON COM
SUBJECT: JEFFREY SACHS VISITS SANAA, WARNS OF ECONOMIC CRISIS

REF: SANAA 1875

Classified By: CDA Nabeel Khoury for reasons 1.5 b and d.

¶1. (U) Summary. Jeffrey Sachs, Director of the UN Millennium Project, projected a bleak future for Yemen without dramatic policy changes and a significant increase in foreign assistance during a visit to Sanaa, July 1-4. In Sachs's view, poor economic performance, declining natural resources, and a looming demographic crisis put Yemen on a direct course for economic collapse and social unrest. Sachs's agenda was to create a greater sense of urgency within the ROYG and to pressure donors to increase aid, but his conclusions matched those of other international observers, which indicate that Yemen may be on the verge of becoming a failed state. End summary.

Yemen: One of the Most Difficult Challenges in the World

¶2. (U) On July 2, Sachs made a presentation to the donor community in which he characterized the situation in Yemen as "one of the most difficult challenges in the world." (Note: Yemen is one of eight pilot project countries selected by the UN as a target for the Millennium Development Goals Project. End note.) He contended that there were serious problems with the ROYG's current strategy for poverty alleviation and development, as the country is struggling simply to maintain existing economic level. With estimates that that the population will double by 2028, rapidly depleting water tables, and no prospects for replacing diminishing oil resources, Sachs predicted a rapid decline in GDP and a "pressure cooker" situation for Yemeni society.

¶3. (U) Sachs attacked the IMF's plan for Yemen as "baby economics." He said it offered the country nothing more than an austerity program without a real development strategy, and would lead to a collapse of living standards for most Yemenis. He was also highly critical of donor countries for not providing sufficient funds to stem the negative trends, saying aid levels need to reach per capita USD 90 if Yemen is to have a "fighting chance." Consistent with his global campaign to assist developing nations, Sachs called for immediate improvements to health, family planning, education, and agriculture. He stressed that to attract foreign investment, Yemen needs to develop the production sector and anti-corruption programs within it. Sachs specifically highlighted Aden Port, tourism, and natural gas as areas for targeted improvement.

Growing Consensus: Yemen Faces Economic Crisis

¶4. (U) Sachs's conclusions echo recent reports from a number of organizations. The World Bank, in its Spring 2005 Economic Update, characterized Yemen's macroeconomic position as increasingly fragile. The Bank reported decelerating GDP growth (now about 3 percent) and consistently declining per capita GDP, as well as high inflation and dwindling current account surpluses. The anticipated decline of oil production over the coming decade (7.5 percent in 2005) will put increased pressure on the ROYG to tap alternate sources of revenue to maintain basic services. Even with the projected removal of fuel subsidies and the introduction of a sales tax (septel), the Bank projects a large fiscal deficit and balance of payments gap that the ROYG will be unable to fill without extensive administrative reforms and growth in the non-oil production sector. The ROYG has shown little progress in improving administrative efficiency or in developing a more diversified economy.

¶5. (U) Similarly, the IMF concluded in its March report on Article IV consultations with the ROYG that without a complete program of policy adjustments, Yemen will face calamity in the near future. The IMF projects that the share of oil revenue to GDP will drop from 25 to 8.5 percent and the budget deficit will increase to 21.9 percent of GDP by ¶2009. In addition, the IMF predicts a current account deficit to exceed 13 percent of GDP and depleted international reserves within five years. As a result of these trends, as well the possibility of a currency crisis

(reftel), it will become increasingly difficult for Yemen to service its public debt.

¶6. (U) Poor economic indicators are coupled with sobering social and political realities. In its annual Failed States Index, the NGO Fund for Peace ranked Yemen the eighth most fragile state in the world, in more danger of collapse than Haiti, Afghanistan, Rwanda, and North Korea. (Note: The index was based on twelve indicators, including demographic pressures, emigration, economic development, and the criminalization of the state. End note.)

¶7. (U) Comment: Sachs met with President Saleh for nearly two hours but, as in the aftermath of similar encounters, there seems to be little indication that Saleh absorbed the immediacy of Yemen's economic problems. Parliament's recent decision to enact elements of the long-awaited economic reform package, including a sales tax and the lifting of the fuel subsidy (septel), give some cause for hope. Sachs is correct, however, that such austerity measures without an effective program for economic development will have a devastating effect on the populace and would likely bring social unrest. With rampant corruption and inefficient administration, it is unclear whether Yemen would be able to absorb successfully the quantity of foreign aid suggested by Sachs. Nevertheless, without some form of immediate international intervention, Yemen is facing an economic collapse that could have a broad ripple effect on regional and international security. End comment.
Khoury